

**HEARING BEFORE THE
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE AND GOVERNMENT SPONSORED
ENTERPRISES**

**"LEGISLATIVE PROPOSALS ON GSE
REFORM"**

**TESTIMONY OF
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**Chair, National Alliance of Independent
Mortgage Bankers**

Chairman Kanjorski, Ranking Member Pryce, and Members of the Subcommittee, my name is Scott Stern and I am Chief Executive Officer of Lenders One of St. Louis, Missouri, and Chair of the National Alliance of Independent Mortgage Bankers (NAIMB). We appreciate the opportunity to present the views of independent mortgage bankers on the impact of proposed legislation on the role of the government sponsored enterprises (GSEs).

Lenders One is the nation's largest mortgage cooperative. Our 100 shareholder companies originate approximately \$40 billion annually in mortgage loans to make homeownership possible in communities across the United States. Since our inception in 2000, Lenders One companies have made over one million home loans. Lenders One plays a unique role in the mortgage industry. Much like the agricultural cooperatives that enabled family farmers to survive in an era of large scale agribusiness, the Lenders One mortgage cooperative permits locally owned independent mortgage bankers to compete on a level playing field in an industry increasingly dominated by mega-originators. Lenders One is founded on the principal that a thriving independent mortgage banking sector increases competition in the industry and provides borrowers with more choice, lower costs, and innovative products. Our advocacy arm, the National Alliance of Independent Mortgage Bankers (NAIMB), promotes the value to consumers and the mortgage finance industry of the community oriented mortgage lender. NAIMB is the only national organization whose membership is comprised solely of residential mortgage bankers whose primary business is home lending.

Independent Mortgage Bankers Support a Strong and Independent Regulator

The Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, play a crucial role in ensuring that independent mortgage bankers like our members can rely on a stable and affordable supply of mortgage capital to loan to borrowers, in good times and bad. The GSEs are also an important business partner in the development of technological innovation and new products that lower costs and expand choice for

borrowers. Additionally, the GSEs help establish a level of standardization in the industry in mortgage underwriting and delivery which makes for an efficient and cost effective marketplace, and helps to maintain a high level of borrower protections.

The vital role played by the GSEs in our housing finance system demands strong safety and soundness regulation to ensure the long term ability of the GSEs to fulfill their market functions. Independent mortgage bankers unwaveringly support the creation of an independent, well funded regulator such as embodied in H.R. 1427, the "Federal Housing Finance Reform Act of 2007, introduced last week by Chairman Frank. The regulator must have the tools necessary to supervise the financial stability, safety and soundness and mission related activities of Fannie Mae and Freddie Mac. Investing the regulator with muscular authority to review and enforce GSE operating standards and compliance with mission is important to maintaining confidence in the enterprises and our housing system.

The Critical Role of the GSEs During Periods of Market Uncertainty

At the same time that we support a strong regulatory regime, we believe it is vital that legislation in no way diminish the role of the GSEs in the housing finance system. The current volatility in the mortgage sector demonstrates the value of the stability that the GSEs bring to the marketplace. As OFHEO Director Lockhart recently stated, in times of uncertainty in the market, "we need strong GSEs and a strong regulator". Fannie Mae and Freddie Mac are the "firewall" that safeguards the nation's housing finance system --and borrowers-- from market shocks and excessive volatility by providing confidence in the mortgage capital markets. During the past five years, as risky mortgage practices have exploded in the private market -- putting borrowers and investors at risk, the GSEs' conventional, conforming market has remained stable and steady, minimizing risks to lenders and borrowers alike.

In 2000, interest only and payment option mortgages amounted to only two percent of the market. However, by the first half of 2006, these types of nontraditional mortgage products represented approximately 40 percent of all loan originations. Similarly, in 1998 subprime lending represented about 5% of the marketplace. By 2005, subprime borrowing was about 20% of the market. Meanwhile, the GSEs and FHA saw a concurrent decline in their market share as borrowers flocked to products whose low initial payments masked high costs and increased risk. In recent weeks we have seen the beginning of the fallout –for borrowers, lenders, and the mortgage market-- from lax underwriting standards and credit policies.

With the mortgage market undergoing rapid change as we enter 2007, the function of the GSEs in ensuring a stable marketplace that keeps the flow of credit open without putting borrowers in high risk loans is more important than ever. We believe it would be a dramatic mistake for Congress to pass legislation which, directly or indirectly, enabled a regulator to diminish the one sector of the housing finance system best shielded from market uncertainty. Indeed, as the marketplace returns to a more traditional market, the GSEs will need regulatory flexibility to respond to the lender and borrower need for safe new products to fill the void left in the wake of contraction of the subprime and non-traditional markets.

We commend Chairman Kanjorski for the deliberative approach he has taken in considering GSE legislation, as befits a matter with dramatic consequences for the nation's housing system. In the last Congress, independent mortgage bankers supported H.R. 1461. We believed H.R. 1461 would establish a world class regulator for the GSEs and ensure the on-going safety and soundness of the enterprises. While we supported the overall approach of that bill, and extend that support to H.R. 1427, we also had some concerns regarding specific provisions. In some cases we were, and remain, wary of the extent of regulatory discretion or regulatory intervention afforded to the regulator.

Our comments on key areas of GSE reform follow:

GSE Portfolio Limits

Independent mortgage bankers oppose efforts to arbitrarily restrict or diminish GSE portfolios, or to impose a “systemic risk” or market size test on the portfolios. Such limitations introduce a significant risk of uncertainty into the housing finance system. Dependable access to mortgage capital is a vital part of the business of independent mortgage bankers. GSE portfolio investment has provided on-going stability to the secondary mortgage market and enabled the ability of the GSEs to ensure a reliable capital supply.

GSE portfolios are large and do carry risk. But we agree with President Reagan’s former budget director, James Miller, who suggested that “the best way to address this issue is to ensure they operate safely and soundly and cover their risks through adequate hedges and capital.” The regulator as originally created by H.R. 1461 has strong powers to monitor the GSE portfolios, without the blunt instrument of portfolio reduction. The enhancements reflected H.R. 1427 would further strengthen the powers of the regulator to monitor, and if necessary adjust portfolio. The proposed language would not, in our analysis, permit the regulator to make adjustments based on the size of the GSEs or an evaluation of systemic risk, and we strongly support making those limitations explicit. Once the specific safety and soundness concerns leading to a portfolio adjustment are addressed, the limitation should be lifted.

Reducing GSE portfolios does not shrink overall risk. The risk is simply reallocated it to other financial institutions which may have fewer tools to manage risk than the GSEs yet carry the same perception of government support. We note that on March 2, 2007, Moodys introduced a new methodology to measure government support for large financial institutions in the event of institutional distress. For example, in assigning a 98% probability of government support for JP Morgan Chase, Moody’s stated “*Due to*

the importance of these operations to the US financial system, the potential disruption to the financial markets from any failure or default by such an institution would be massive, and for this reason Moody's assigns this virtually certain support assumption."

Likewise, Citibank received a 98% probability of government support, Bank of America 95%, Wells Fargo 70%, and Wachovia 70%.

Regulatory Authority Over Capital

We support the authority of the regulator to adjust minimum capital ratios. However, we believe H.R. 1427 should clarify that any adjustment in minimum capital must be specifically tied to safety and soundness concerns identified by the regulator through a deliberative and transparent process. Once the conditions change or the problems are rectified to the regulator's satisfaction, minimum capital should return to the statutory level. The requirement for a safety and soundness finding before minimum capital is adjusted is consistent with a desire to balance the new regulator's enhanced authority over capital with Congressional guidance on how such authority is to be used.

The United States has a long-standing policy of federal support for the housing sector through the activities of the GSEs. Unbridled regulatory authority over capital presents the risk that the historic commitment to housing could erode through shifting regulatory attitudes toward the federal role in housing. By linking capital adjustments to safety and soundness findings, Congress will ensure the regulator can adequately supervise the financial stability of the GSEs without substituting the regulators judgment on matters of fundamental national housing policy.

Regional Adjustments for Conforming Loan Limits

Independent mortgage bankers support the provision in H.R. 1427 to increase the conforming loan limits in high cost regional markets. This provision offers significant benefits to families living and working in high cost housing areas.

The inability of the GSEs to purchase loan products from high cost areas has contributed to an high concentration of loan products the federal banking regulators consider to be risky for borrowers and lenders. The non-traditional guidance issued last year by the regulators is expected to reduce the availability of such loan products. An increase of the GSE loan limit in these areas will enable lenders to continue to extend credit to prospective homebuyers in high cost markets, with less risk exposure for both the borrower and the lender.

In addition, because FHA and VA loan limits are limited by the GSE conforming ceiling, an adjustment to the GSE limit in high cost areas will also expand borrower access to the government programs which have experienced significant declines in high cost markets.

Some have suggested that regional mortgage limits would create operational difficulties in the mortgage industry. While our members would welcome easy to implement statewide limits, we do not believe the challenge of managing regional limits is a reason not to support increased conforming loan limits that would benefit borrowers in high cost areas.

Program Approval and the “Bright Line”

Independent mortgage bankers caution against overly restrictive program approval requirements and oppose a “bright line” test for new GSE products and programs.

- **Bright Line**

The “bright line” test proposed by GSE competitors would hamper competition in the marketplace by making it harder for independent mortgage bankers to work with the GSEs to lower costs and increase choices for consumers.

The GSE charter authorizes Fannie Mae and Freddie Mac to operate in the secondary market for mortgages. The GSE reform debate has generated much discussion about the need for a clear delineation between the primary and secondary mortgage markets. As “on the ground” mortgage bankers, we are puzzled by the suggestion of ambiguity about the reach of GSE activities. The distinguishing feature of the primary market is loan origination. Under their charter, the GSEs may not originate loans. We are unaware of any mortgage banker who does not know what a loan origination is. A brighter line than the existing prohibition on loan origination would be hard to draw.

Some GSE activities, such as the deployment of automated underwriting (AU) systems, enable lenders to improve the process of loan origination. The fact that a GSE process or technology *assists* a loan origination does not mean that the GSEs are engaged in primary market activity. And the value of such activities can be significant. For example, by providing a universal –and portable—underwriting decision, the GSE AU systems increase competition by permitting lenders to fund and sell loans to the best pricing in the market, whether directly to the GSEs or to a large aggregator. From the borrower perspective, the GSE systems have lowered costs and sped approvals by enabling lenders to determine in seconds, rather than in days and weeks, whether a loan meets requirements for purchase in the secondary market.

A bright line test that goes beyond the existing delineation of primary and secondary markets would effectively change the GSE charter. We believe that a strong, independent regulator employing current GSE charter restrictions, prudential safety and soundness standards, and a bank-like program approval process would have ample authority to supervise GSE charter compliance without diminishing innovation.

- **New Program Approval**

As business partners of the GSEs, independent mortgage bankers support the ability of the GSEs to work with lenders to innovate and quickly implement new products and business processes. The ideal structure of a program approval process would encourage the GSEs and regulator to establish a consultative relationship that enables the regulator to monitor the development and introduction of new GSE programs and step in where necessary for charter compliance. We favor a bank-like approach that requires prior program approval only in the case of significantly new programs, while product modifications, enhancements and updates would be noticed to the regulator through regular communication. Legislation should avoid creating a cumbersome regulatory approval process for new mortgage products that would stifle innovation and prevent the GSEs from “leading the market” consistent with their mission.

Conclusion

We urge the Subcommittee to continue its commitment to balanced GSE reform as it considers legislative proposals to overhaul GSE regulation. We support the approach taken by Chairman Frank in H.R. 1427, the "Federal Housing Finance Reform Act of 2007. Addressing the issues that we have outlined will help ensure that final legislation passed by the House will preserve a viable, long-term business model for the GSEs to carry out their secondary market and affordable housing functions in safe and sound manner that maintains confidence in the world’s most successful housing finance system.